

Message Text

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SUBJECT: RUMOR GOVERNMENT: ECONOMIC STATUS REPORT

REF: (A) ROME 7376; (B) ROME 7482; (C) ROME 7576; (D) ROME 7793;
(E) ROME 8289

1. SUMMARY: NEW RUMOR GOVERNMENT HAS MOVED QUICKLY IN
ADOPTING SERIES OF SHORT-TERM ECONOMIC MEASURES DEALING WITH
PRESSING ECONOMIC PROBLEMS WITH GOI COMMITTED TO CONSOL-
IDATING ECONOMIC GROWTH AND CONTROLLING INFLATION. HOWEVER,
EXPANSIONARY BUDGETS FOR 1973 AND 1974 NOT COMPATIBLE WITH
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ANTI-INFLATIONARY OBJECTIVES OF NEW GOVERNMENT. MOUNTING
PRESSURES IN PARLIAMENT FOR ENACTMENT LONG-AWAITED
SOCIAL REFORM MEASURES AND FRAGILE TRUCE ON LABOR FRONT AS
UNIONS EXPECT POSITIVE RESULTS FROM PRICE CONTROLS ARE MAJOR

CHALLENGES IN COMPLICATED BACKGROUND AGAINST WHICH NEW GOVERNMENT IS ATTEMPTING TO ACHIEVE RESULTS IN ECONOMIC FIELD. END SUMMARY.

2. OVERALL OBJECTIVES OF NEW RUMOR CENTER-LEFT COALITION TO BREAK SEVERE INFLATIONARY SPIRAL AND CONSOLIDATE ECONOMIC RECOVERY ARE REFLECTED IN SERIES OF MEASURES TAKEN END OF JULY AND EARLY AUGUST AND REPORTED SEPARATELY. ANTI-INFLATION PACKAGE (DESCRIBED REF A) WAS FOLLOWED BY MEASURES DESIGNED REALLOCATE BANK CREDIT FROM LARGE TO SMALL AND MEDIUM INDUSTRIES TO ENCOURAGE INVESTMENT (REF B). SHORTLY AFTERWARDS STEPS WERE TAKEN TO SUPPORT LIRA WITH CONTROLS ON SPECULATIVE ACTIVITIES IN AREAS OF IMPORT PAYMENTS AND CAPITAL INVESTMENT ABROAD (REF C). MAJOR CHALLENGE FOR "TROIKA" WAS DRAFTING OF 1974 BUDGET WITH GOI CAUGHT IN DILEMMA OF INFLATIONARY EFFECTS OF LARGE BUDGET DEFICITS FORECAST FOR 1973 AND 1974 AND MORE RECENT GOI OBJECTIVE TO CONSOLIDATE ECONOMIC GROWTH AND CONTROL INFLATION.

3. ANTI-INFLATION PROGRAM CONSISTS OF COMPREHENSIVE PRICE FREEZE AND LIMITED RENT FREEZE BUT DOES NOT DIRECTLY AFFECT WAGES, PROFITS OR INTEREST RATES (REF A). GOI HAS MADE CLEAR ITS INTENTION TO ENFORCE RIGOROUSLY PRICE FREEZE REGULATIONS. PAST FEW WEEKS HAVE SEEN ESTABLISHMENT OF PREFECTURAL PRICE COMMITTEES THROUGHOUT ITALY AND CALL FOR PUBLIC TO REGISTER COMPLAINTS WITH AUTHORITIES REGARDING PRICE FREEZE VIOLATIONS. SUCH COMPLAINTS HAVE RESULTED IN SPATE OF LEGAL ACTIONS AGAINST FIRMS AND INDIVIDUAL STOREKEEPERS AS PREFECTS TRY TO HOLD PRICE LINE ON MAJOR FOOD ITEMS. TO DATE, HOWEVER, FINES AGAINST PRICE FREEZE VIOLATORS HAVE BEEN VERY LIGHT AND LEVIED AGAINST SMALL SHOPKEEPERS WITH REAL TEST YET TO COME AGAINST LARGE PRODUCERS. PASTA AND BREAD PRODUCERS AND MEAT IMPORTERS ARE BEING CAUGHT IN PROFIT SQUEEZE BETWEEN RISING COSTS OF IMPORTED WHEAT, FLOUR, AND MEAT AND FROZEN DOMESTIC SALE PRICE THESE ITEMS. INDUSTRY SPOKESMEN HAVE PRESSED FOR INCREASE IN DOMESTIC SALE PRICE, AND GOI HAS LIMITED OFFICIAL USE
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AGREED TO RAISE PRICE OF SOME KINDS OF BREAD WHILE PUBLICLY ASSURING PRODUCERS OF ADEQUATE SUPPLIES OF WHEAT AND FLOUR AT REASONABLE PRICES. REAL DANGER EXISTS, HOWEVER, THAT SUPPLIES WILL BE WITHHELD BECAUSE OF CONTINUING PROFIT SQUEEZE WITH EVENTUAL CREATION OF A BLACK MARKET FOR PASTA, MEAT AND POSSIBLY OTHER FOOD ITEMS.

4. IMPACT OF AGGRESSIVELY-ENFORCED PRICE CONTROL MECHANISM ON ITALIAN CONSUMERS HAS BEEN POSITIVE. CONSUMERS AND LABOR UNIONS NOW WATCHING TO SEE WHETHER GOI ABLE TO CONTROL RISING PRICES WHICH, DURING MAY AND JUNE, AVERAGED 20 PERCENT ANNUAL RATE OF INCREASE. PRICE CONTROL MECHANISM BEING ENFORCED DURING AUGUST HOLIDAY PERIOD WILL

PROVIDE CONSUMERS WITH WELCOME CHANGE FROM PREVIOUS YEARS WHEN FEW STORES WHICH REMAINED OPEN DURING HOLIDAY PERIOD TENDED TO RAISE PRICES INDISCRIMINATELY (SEE ROME 4970 DATED AUGUST 31, 1972).

5. CREDIT RESTRAINT MEASURES DESCRIBED REF B AND POSSIBILITY OF CREDIT SQUEEZE CAUSING SOME CONCERN IN BANKING AND FINANCIAL CIRCLES DESPITE GOI ASSURANCES THAT MEASURES WILL BE CLOSELY MONITORED TO GUARD AGAINST DEFLATIONARY IMPACT. EXCHANGE CONTROL AND OTHER MEASURES HAVE HAD POSITIVE IMPACT AS LIRA HAS STRENGTHENED AGAINST DOLLAR, STERLING AND EC SNAKE WITHOUT INTERVENTION BY CENTRAL BANK. APPROXIMATELY 12 PERCENT DEVALUATION OF LIRA SINCE LAST FEBRUARY AGGRAVATING PROBLEM OF RISING COSTS OF IMPORTS ALTHOUGH EXPORTS ALSO EXPECTED TO INCREASE AS RESULT OF DEVALUTATION, POSSIBLY BY END OF 1973.

6. 1974 BUDGET RECENTLY APPROVED BY COUNCIL OF MINISTERS REFLECTS GOI DILEMMA OF CONSOLIDATING ECONOMIC RECOVERY AND CONTROLLING INFLATION. GOI AT SAME TIME BURDENED WITH 1973 DEFICITORY BUDGET WHICH WAS FRAMED IN 1972 TO GIVE FISCAL STIMULUS TO THEN-STAGNATING ECONOMY AND WHICH WILL RESULT IN DEFICIT OF 7,700 BILLION LIRE (\$13.7 BILLION) AT TIME WHEN ECONOMIC REVIVAL STRONGLY IN EVIDENCE. 1974 BUDGET PROVIDES FOR PROJECTED CASH DEFICIT OF 7,400 BILLION LIRE (\$12.7 BILLION) AND REMAINS HIGHLY EXPANSIONARY. NEW BUDGET IS DESCRIBED AS "AUSTERE" BY TREASURY MINISTER LA MALFA BECAUSE FOR FIRST TIME IN RECENT MEMORY BUDGETARY SPENDING LIMIT OF PRECEDING LIMITED OFFICIAL USE LIMITED OFFICIAL USE

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YEAR HAS BEEN SLIGHTLY REDUCED IN SUCCEEDING BUDGET. GOI HAS KEPT DOWN ADDITIONAL SPENDING REQUESTS, WHICH, ACCORDING TO LA MALFA, WOULD HAVE RESULTED IN DEFICIT OF \$19 BILLION HAD THESE REQUESTS BEEN INCLUDED IN 1974 BUDGET, AND CASH DEFICIT OF \$24 BILLION HAD 1974 CASH DEFICIT BEEN PERMITTED TO INCREASE IN ACCORDANCE WITH 1970-1973 BUDGETARY TREND. NONETHELESS IN OUR JUDGEMENT THE MAGNITUDE OF BUDGETARY DEFICITS IN BOTH 1973 AND 1974 ARE NOT COMPATIBLE WITH ANTI-INFLATIONARY OBJECTIVES OF NEW GOVERNMENT. LA MALFA HAS DESCRIBED DEFICIT IN 1974 BUDGET AS "ABSOLUTE LIMIT" ON SPENDING AND HAS ISSUED CALL FOR PARLIAMENTARY SENSE OF RESPONSIBILITY, STATING PUBLICLY THAT SPENDING LAWS APPROVED BY PARLIAMENT MUST, IN ACCORDANCE WITH CONSTITUTION ALSO PROVIDE MEANS OF FINANCING WHICH ACCORDING TO LA MALFA MUST TAKE FORM OF INCREASED TAXES OR REALLOCATION OF APPROPRIATED FUNDS. BUDGET DEFICIT IN ANY EVENT WILL BE DIFFICULT TO CONTAIN IN VIEW OF UNCERTAIN REVENUE IMPACT OF INDIRECT (IVA) TAX REFORM LAW WHICH WENT INTO EFFECT LAST JANUARY 1, AND DIRECT (INCOME) TAX REFORM LAW SCHEDULED TO BE ADOPTED NEXT

JANUARY 1.

7. HARD-NOSED ATTITUDE OF LA MALFA REGARDING
LIMITATION ON SPENDING AND REQUIREMENT OF FINANCIAL COVERAGE
OF SPENDING LAWS ALREADY CAUSING HIM DIFFICULTIES.
REQUESTS FOR IMPROVED PENSIONS AND OTHER SOCIAL
BENEFITS ARE BEING MET WITH COMMENT
FROM GOI THAT GASOLINE PRICES WILL HAVE TO BE RAISED TO
MEET INCREASED COSTS (AS WELL AS TO KEEP OIL COMPANIES
IN BUSINESS). ALSO, PAY AND OTHER BENEFITS FOR CIVIL
SERVANTS, POLICE AND MILITARY RECENTLY APPROVED BY COUNCIL
OF MINISTERS WILL COST GOI SOME 1,500 BILLION LIRE (\$2.6
BILLION) OVER NEXT TWO YEARS AND HAS BEEN DESCRIBED IN SOME
ECONOMIC CIRCLES AS "INFLATIONARY BOMB". LA MALFA HAS
STATED PUBLICLY THAT LATTER SPENDING MEASURE CONSTITUTES
SERIOUS PROBLEM FOR GOI WHICH NOW CONSIDERING POSSIBILITY
OF FINANCING NEW SPENDING MEASURES THROUGH SELECTIVE
INCREASES IN IVA TAX RATES. NEW SPENDING MEASURE IS
INDICATIVE OF MOUNTING PRESSURES IN PARLIAMENT FOR
ENACTMENT LONG-AWAITED SOCIAL REFORM IN VARIETY OF FIELDS,
WITH MORE TO COME WHEN PARLIAMENT RECONVENES. VOLPE
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